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Nos. 85-1963 and 85-2006

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

TYLER PIPE INDUSTRIES, INC.,
Appellant,

v.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,
Appellee.

NATIONAL CAN CORPORATION, *et al.*,
Appellants,

v.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the Supreme Court of Washington

BRIEF OF THE NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, NATIONAL ASSOCIATION OF COUNTIES, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, AND U.S. CONFERENCE OF MAYORS AS *AMICI CURIAE* IN SUPPORT OF APPELLEE

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QUESTIONS PRESENTED

1. Whether Washington's gross receipts tax on manufacturing and wholesaling activities within the State discriminates against interstate commerce, in violation of the Commerce Clause, because a local manufacturer-seller that pays the wholesale tax is protected from double taxation by an exemption from the manufacturing tax.

2. Whether the Commerce Clause precludes the imposition of any gross receipts tax, given that gross receipts, used as a measure of the tax base, may include value derived from activities in other States.

3. Whether either the Commerce Clause or the Due Process Clause precludes Washington from taxing an out-of-state manufacturer that engages in regular, substantial business activity in the State through independent sales representatives rather than employees.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

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INTEREST OF THE *AMICI CURIAE*

The *amici*, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments. This case concerns the constitutionality of a business and occupation tax imposed by the State of Washington on busi-

nesses that manufacture or sell goods at wholesale in the State. If this Court accepts the arguments raised against the tax, the State has estimated that the actual and projected potential tax refund liability will exceed $423 million, exclusive of interest. J.A. 205. In addition, because a gross receipts tax is a kind of sales tax,[1] the case has significant potential to affect the ability of state and local governments to impose sales taxes on national businesses. Since 1944, the general retail sales tax has been the most important tax source of state government.[2]

Since this Court's decision in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), invalidating a West Virginia tax, Washington has been the only State that imposes a general business and occupation tax. Washington imposes no income tax, choosing instead to raise the revenue necessary to fund essential state functions and other governmental programs from the business and occupation tax, as well as a sales tax. *Amici* are concerned that invalidation of the tax challenged in this case will severely limit the policy choices constitutionally available to state and local governments in formulating tax policy and, in particular, will require Washington to overhaul its entire tax structure. The power to raise revenue by imposing taxes is the essence of sovereignty; and the States, as sovereigns in our constitutional system of government, "possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *The Federalist* No. 32, at 198 (A. Hamilton) (Mentor ed.

[1] J. Hellerstein & W. Hellerstein, *Cases and Materials on State and Local Taxation* 551 (4th ed. 1978).

[2] Forty-five States and the District of Columbia currently impose sales taxes, which account for 32% of their tax collections. In addition, as of October 1984, local sales taxes were imposed in 26 States. About 6,400 local governments annually collect $12.6 billion, an average of 10.2% of 1984 tax revenues. In some cities, however, sales taxes account for 60% of revenue. J. Aronson & J. Hilley, *Financing State and Local Governments* 94 (4th ed. 1986) (citing Census Bureau data).

1961). In our view, the Constitution requires the widest possible latitude for state and local taxes and the exceedingly sparing application of federal preemption under the Commerce Clause or the Due Process Clause.

As a Nation, we have come to another turning point in the balance of power and responsibilities between the federal government and state and local governments. For years, the federal government has appropriated an increasing share of the national income; but the reciprocity previously provided through revenue sharing has been abandoned, and grants-in-aid have been severely reduced. Adding even further to the financial burden on state and local governments is Congress's increasing reliance on state and local budgets to pay for social service programs and benefits previously funded by the federal government. The struggle of state and local governments for economic solvency and self-sufficiency cannot be successful if the limited tax base available to state and local governments continues to be eroded through federal preemption. Increasingly, national businesses are asserting federal preemption of state and local taxes to avoid paying their fair share for the protection and the benefits that government provides. *E.g.*, *R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986); *Wardair Canada, Inc. v. Florida Department of Revenue*, 106 S.Ct. 2369 (1986); *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). Such preemption not only imposes an unfair burden on other taxpayers but undermines the State's ability to govern because, quite simply, government services and benefits cost money. *Amici* therefore urge the Court to reaffirm the standards developed in its recent cases: state taxes are not invalid under the Supremacy Clause unless a finding of conflict with constitutional principles or with federal law is clearly and unavoidably compelled.

Amici submit that the decisions of the Washington Supreme Court are correct. Because this Court's decision will have a direct effect on matters of prime importance

to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.[3]

STATEMENT OF THE CASE

Amici adopt appellee's statement of the case and emphasize the following points. The appellant corporations each conduct at least part of their business within the State of Washington. They challenge the constitutionality of Washington's levy of its business and occupation ("B & O") tax. The B & O tax is assessed for the "act or privilege of engaging in business activities" in the State of Washington and is levied against the value of all products manufactured or sold at wholesale in the State. Wash. Rev. Code § 82.04.220. The tax imposed is a percentage (0.44%) of the gross receipts derived from the sale of the products.

The tax, levied uniformly on all intrastate or interstate businesses that manufacture or wholesale products in Washington, contains a "multiple activities exemption," applicable to a business that both manufactures and sells its product within the State. Wash. Rev. Code § 82.04.440. That business is exempt from the manufacturing tax on the product because it pays the wholesale tax on the same product.

None of the appellants pays a gross receipts tax on manufacturing or wholesaling to any other State. Appellants challenge the B & O tax on the ground that it discriminates against interstate businesses and is not fairly apportioned to the activities performed in Washington.

Appellant Tyler Pipe also challenges the B & O tax on the ground that the company does not have sufficient "nexus" to the State of Washington to be subject to a

[3] Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

state tax there. Tyler Pipe solicits substantial sales and provides services to its customers in Washington through exclusive sales agents who are independent contractors, rather than employees of the company. Although these agents perform services functionally equivalent to those performed by direct employees of other companies, Tyler Pipe argues that their status as independent contractors creates a shield insulating it from tax liability.

SUMMARY OF ARGUMENT

This Court properly refuses to strike down a state tax as unconstitutional absent a clear and convincing showing that it has an unlawful effect. This restraint recognizes the essential power that States retain under our federal system to raise revenue by taxation so that they may provide the services and other attributes of a civilized society. The Court has invalidated state taxes under the Commerce Clause only when they conferred a direct benefit on local business and when the litigant challenging a tax has demonstrated that it suffers an actual adverse impact.

The recent decision in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), on its facts, merely stands for the proposition that a state tax is unconstitutional if it facially discriminates against interstate commerce. Yet appellants, relying on *dicta* in *Armco*, would extend its holding to facially neutral taxes on the basis of hypothetical discrimination. This departure from settled law is particularly disturbing because it ignores not only the traditional principles applicable to state tax challenges, but also the concept that a litigant must establish injury in fact to confer Article III standing. This Court should reject appellants' efforts to expand *Armco*.

When Washington's B & O tax is judged by traditional standards, it is clear, as this Court has held on three previous occasions, that it passes constitutional muster. The tax treats interstate and intrastate businesses equally and allows them to make tax-neutral decisions. In short, it does not discriminate against interstate commerce.

Appellants are no more successful on their fair apportionment claim. Appellants have not shown that the tax is out of all proportion to the business conducted in the State, which is the apportionment standard applicable to state taxation of interstate businesses. Appellants can show at most an incidental burden of multiple taxation, stemming from a partial overlap in the measures of various taxes imposed by other States. Any such overlap, however, results not from any infirmity in Washington's tax, but merely because Washington's tax differs from those of its neighbors. Washington is entitled to apportion its gross receipts taxes by allocation and is not required to use an apportionment formula appropriate to income taxes. Washington's allocation taxes a business exactly in proportion to its activity in the State.

Finally, appellant Tyler Pipe's suggestion that a business can avoid its fair burden of state taxation by relying on independent contractors rather than employees to solicit sales and to service clients must be rejected out of hand. Tyler Pipe's substantial business in Washington enjoys the services and benefits conferred by the State; whether it does so through direct employees or independent contractors has no constitutional significance.

ARGUMENT

I. THE POWER TO TAX IS AT THE CORE OF STATE SOVEREIGNTY, AND THE STATES ARE ENTITLED TO SUBSTANTIAL DISCRETION IN DESIGNING THEIR TAX SYSTEMS.

Appellants broadly challenge the specific tax scheme enacted by the State of Washington. Appellants' challenge is fueled in great part by *dicta* in this Court's recent opinion in *Armco Inc. v. Hardesty,* 467 U.S. 638 (1984). Certain language in *Armco* represents a dramatic departure from prior decisions judging the validity of state tax systems. As we explain more fully in Part II, *Armco* is not controlling here. But we also urge this Court to recognize that the broad *dicta* in *Armco* are not

consistent with the respect that the Court traditionally shows for state tax schemes, reflecting its appreciation of the fundamental relationship between the power to tax and the existence of vital state governments. In brief, the Court has repeatedly recognized that (1) the power to tax to raise revenue is an essential attribute of state sovereignty, (2) the Constitution does not require uniformity among the States as to the type of taxes imposed, and (3) the choice of a particular tax system is by its nature legislative. These principles, more fully discussed below, should inform this Court's analysis, and, when applied tc this case, demonstrate the constitutionality of Washington's tax scheme.

A. The Power To Tax Is An Essential Attribute Of State Power.

The power to impose taxes in an inherent attribute of state sovereignty. The States "possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *The Federalist* No. 32, at 198 (A. Hamilton) (Mentor ed. 1961). Taxing authority is essential if States are to provide services and the other features of a "civilized society" to their citizens and to those businesses, both intrastate and interstate, that choose to conduct business within a State's borders. *See Exxon Corp. v. Wisconsin Department of Revenue,* 447 U.S. 207, 228 (1980); *see also Union Pacific Railroad v. Peniston,* 85 U.S. (18 Wall.) 5, 33 (1873) (without the power to tax, "it is manifest the state governments would be paralyzed").

Accordingly, constitutional limitations on a State's power to tax must be construed in light of the very real needs of the State to raise revenue (*id.* at 30-31):

> It cannot be that a State tax which remotely affects the efficient exercise of a Federal power is for that reason alone inhibited by the Constitution. To hold that would be to deny to the States all power to tax persons or property . . . . The States are, and they must ever be, coexistent with the National govern-

> ment. Neither may destroy the other. Hence the Federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the States, or prevent their efficient exercise.

A "practical construction" of the Constitution confers upon the States substantial discretion in levying taxes; limitations imposed by the Commerce Clause or the Due Process Clause should be sparingly applied only to the most compelling cases of clear constitutional violation. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 622 (1981) ("This Court has indicated that States have considerable latitude in imposing general revenue taxes.").

B. The Choice Of A Tax Scheme Is An Exercise Of Legislative, Not Judicial, Prerogative.

Appellants broadly attack the constitutionality of Washington's B & O tax, a gross receipts tax adopted as a general revenue device. Although a State's power to tax is limited by the Commerce Clause, this Court has steadfastly refused to substitute its judgment for that of the state legislature as to the propriety of any paricular tax system. The Constitution is neutral with respect to a preference for any particular kind of tax. *See Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 279 (1978). In *Moorman*, this Court was faced with a challenge to an income tax scheme that was unique among the States. The "asserted constitutional flaw" of the challenged tax was that "it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation." *Id.* at 278. If that characteristic itself made the tax unconstitutional, only a uniform rule for state income taxes, imposed by the Court, could have overcome the infirmity. This the Court refused to do. "Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State." *Id.* at 279. Accordingly, Washington's B & O

tax is not infirm solely to the ground of its uniqueness and the consequent difficulty in making it fit neatly with the varying tax structures of other States.

The Court should be particularly reluctant to strike down Washington's B & O tax because it represents the "longstanding tax policy" of the State. *See Moorman Manufacturing*, 437 U.S. at 280 n.16. Washington has levied a B & O tax since 1953 and has never levied a personal or corporate income tax, the only serious alternative to a gross receipts tax. In fact, the State Supreme Court has held that a corporate income tax is unconstitutional under the uniformity clause of the state constitution. *See Power, Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951). As an expression of the political will of the people of the State of Washington, the choice of a B & O tax should be respected by this Court.

An adverse decision on the apportionment issue in this case may well preclude any gross receipts taxes, notwithstanding this Court's repeated judgment that the tax is constitutional.[4] Appellants argue that Washington must apportion part of the manufacturing value or wholesale price of a product to activity in other States. But a gross receipts tax is a tax on *gross* receipts, *i.e., all* of a business' receipts within the taxing jurisdiction. Accordingly, a holding that Washington may not constitutionally tax all of the gross receipts of manufacturing or wholesaling activity within the State is essentially a holding that no gross receipts tax may ever be imposed.

An adverse decision on the discrimination issue may also force Washington to abandon its gross receipts tax system. The discrimination challenge is based on the multiple activities exemption, which protects local manufacturer-sellers from double taxation by exempting them

[4] *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560 (1975); *Chicago Bridge & Iron Co. v. Washington Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983).

from paying the manufacturing tax on the same goods on which they have paid the wholesale tax.[5] As we discuss more fully below (pp. 16-17), the multiple activities exemption serves two essential purposes: to prevent discrimination *against* local business, and fairly to "encourage the growth and development of intrastate commerce and industry" (*see Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336 (1977)). A decision that Washington must impose a double gross receipts tax on its local manufacturer-wholesalers would leave the State with only two choices: either adopt taxing policies that are plainly harmful to the economic future of the State, or abandon its strongly held political consensus against income taxation. This is a choice that Washington should not have to make.

II. WASHINGTON'S GROSS RECEIPTS TAXES ON MANUFACTURING AND WHOLESALING DO NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

The constitutional test for the validity of a state tax is found in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), which held that a tax is valid under the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce,

[5] In an attempt to protect the source of the essential revenue collected through the B & O tax, the Washington state legislature, after this Court's decision in *Armco*, enacted a contingent tax credit available to companies that manufacture out of the State, to go into effect if there were a judicial decision that the multiple activities exemption discriminated against interstate commerce. The credit would be available to out-of-state manufacturers against Washington's wholesaling tax for amounts paid as gross receipts taxes on manufacturing in other States. Wash. Rev. Code § 82.04.440(4). Appellants' claims of discrimination, however, are not limited to the failure of the current tax scheme to provide the credit contained in this fallback provision. Should the Court accept any of these broader arguments, the fallback provision might not be sufficient to sustain the multiple activities exemption, which is integral to Washington's gross receipts tax system.

and is fairly related to the services provided by the State." Appellants National Can, *et al.*, rest their argument primarily on the contention that Washington's gross receipts taxes on manufacturing and wholesaling discriminate against interstate commerce. Appellants also challenge the fair apportionment prong of the test. Appellant Tyler Pipe challenges the nexus, fair apportionment, and discrimination prongs of the test.

A. *Armco* Is Not Controlling In This Case.

All the appellants rest their discrimination claims primarily upon the Court's opinion in *Armco*. But *Armco* is not controlling here. *Armco* stands only for the proposition that a state tax that facially discriminates against interstate commerce in invalid. The issue in *Armco*, as the Court noted, was whether "West Virginia's *wholesale* gross receipts tax, *from which local manufacturers are exempt*, unconstitutionally discriminates against interstate commerce." 467 U.S. at 639 (emphasis supplied). The Court found that it did. *Id.* at 642. West Virginia sought to overcome this facial discrimination by arguing that the wholesale tax was a constitutionally acceptable equivalent for the State's manufacturing tax, which was not assessed against out-of-state businesses. *Ibid.* The Court rejected this argument because of differences in the rates and the bases of the two taxes. *Id.* at 643.

Having rejected West Virginia's only defense to the facial discrimination of the wholesaling tax, the Court need not have gone any further; and had the opinion stopped there, the discrimination challenge in this case might well not be before the Court. This Court has repeatedly upheld the Washington gross receipts tax, and none of the discussion of facial discrimination aids appellants, who in fact do not rely on the holding of *Armco*. Appellants' challenge arises only because the *Armco* opinion contains certain generalized assumptions and broad conclusions regarding the validity of state tax schemes. These statements, which were not necessary to dispose of the case, are properly regarded as *dicta* and

therefore not controlling precedent. *See R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 399 (1821). They should, in particular, be treated as noncontrolling *dicta* because they represent such serious departures from the Court's prior cases. In at least three respects, the *Armco* opinion breaks with the Court's long-standing approach to discrimination claims.

First, the Court did not evaluate the combined effect of the West Virginia manufacturing and wholesale taxes, and thus did not consider the actual effect of the State's tax system on Armco. In fact, as a practical matter, the tax scheme imposed a substantially higher tax rate on an in-state manufacturer than on an out-of-state wholesaler. But the Court explicitly stated that it would not require Armco to prove "actual discriminatory impact on it." 467 U.S. at 644. This approach departs from the established test that unconstitutional discrimination means actual discrimination against interstate commerce in the form of a direct commercial advantage to local business. *See Boston Stock Exchange*, 429 U.S. at 329.

Second, and more important, for the first time ever, the Court judged the West Virginia tax system solely on the basis of hypothetical discrimination arising from the interplay of that system with taxes that *could be* (but in fact were not) imposed by *other States*. The Court never found, and could not find on the record before it, that the West Virginia tax system had an actual discriminatory impact on interstate commerce. As Justice (now Chief Justice) Rehnquist noted in dissent, the impact of West Virginia's system as a whole fell more heavily on intrastate than on interstate commerce. 467 U.S. at 647. The discriminatory impact was found only by reference to hypothetical taxes that other States might impose. Prior cases, however, demand that state taxes challenged under the Commerce Clause be judged by their "practical operation" (*Best & Co. v. Maxwell*, 311 U.S. 454, 456 (1940)) or "actuality of operation" (*Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 69 (1963)).[6]

Third, the Court employed, also for the first time, the principle of "internal consistency" as a test for unconstitutional discrimination. Although the Court had previously announced the internal consistency standard as a measure of the fair apportionment of a state income tax (*see Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983)), no case had suggested that the internal consistency principle was relevant in determining whether a state tax was discriminatory.

There are strong reasons why the *Armco dicta* should not be deemed controlling in this or any other case. Foremost is that the application of a "hypothetical discrimination" test is completely at odds with the constitutional prerequisites for standing imposed by the "cases and controversies" requirement of Article III, § 2 of the Constitution. *See, e.g., Valley Forge Christian College v. Americans United*, 454 U.S. 464, 471-72 (1982). One of the fundamental requirements for standing is a showing of "some actual or threatened injury" to the plaintiff. *Ibid.* "Abstract injury is not enough" (*City of Los Angeles v. Lyons*, 461 U.S. 95, 101 (1983)), and standing is not conferred as a result of a "conjectural" or "hypothetical" injury. *Id.* at 102.

The actual injury requirement should defeat jurisdiction of a claim based solely upon the taxpayer's ability to

[6] In *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), the Court invalidated a Washington gross receipts tax that was not fairly apportioned to activities within the State. *See id.* at 439. The Court did not require a showing of actual discrimination through multiple taxation, but found that the absence of fair apportionment was itself sufficient to invalidate the tax. The Court did not hold that a fairly apportioned tax could be struck down without any showing of actual discrimination against interstate commerce. The current Washington gross receipts taxing system is fairly apportioned, as we show below (pp. 21-25); and, therefore, nothing in *Gwin, White* suggests that it is invalid.

imagine a tax in another State which, in combination with the challenged tax, might result in discrimination against an interstate business. The Court has consistently applied rigorous standing requirements to taxpayer suits. *See Valley Forge; Flast v. Cohen*, 392 U.S. 83 (1968). To be sure, appellants have an economic, rather than political or social, stake in the outcome of this case: they would like to avoid some or all of their tax obligations to the State of Washington. Nevertheless, a claim of a hypothetical tax burden is simply not a case or controversy involving the "actual or threatened injury" required under Article III.

If appellants' claims are addressed, this Court's recent opinion in *R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986), indicates the appropriate course. *Reynolds* disposed of a similar challenge to a state tax based on *dictum* in a previous opinion, *Xerox Corp. v. Harris County, Texas*, 459 U.S. 145 (1982), which had suggested that any state property tax imposed on imported goods stored in customs bonded warehouses was invalid. In *Reynolds*, the Court unanimously upheld a state tax imposed on goods imported and stored for domestic use, easily limiting *Xerox* to its facts and its narrow holding, which concerned only goods stored for re-export. We urge the Court in this case similarly to separate the facts and the holding of *Armco* from its *dicta*. The West Virginia wholesaling tax under review in that case was found to discriminate on its face against interstate business. The Washington tax at issue here does not. When the *dicta* in *Armco* are stripped away, as *Reynolds* teaches, Washington's tax clearly passes constitutional muster. This Court has so held on three prior occasions. See note 4, *supra*.

B. Washington's Wholesaling Tax Does Not Discriminate Against Interstate Commerce.

The actual holding in *Armco* provides no support for appellants' challenge to the wholesaling tax because *Armco* held only that a facially discriminatory tax violated the Commerce Clause. The Washington wholesaling tax is not discriminatory on its face or in its operation. Every wholesaler in the State pays a wholesaling gross receipts tax of 0.44%. The tax applies equally to wholesalers who manufacture within the State and wholesalers who manufacture outside the State. Every wholesaler is treated the same as every other wholesaler.

Appellants' argument that the Washington wholesaling tax nevertheless violates the Commerce Clause relies on *Maryland v. Louisiana*, 451 U.S. 725 (1981). National Can Br. 7-8; Tyler Pipe Br. 16-17. In *Maryland*, a number of States and pipeline companies challenged Louisiana's first-use tax as applied to natural gas brought into Louisiana from the Outer Continental Shelf ("OCS"). *Id.* at 728. Louisiana imposed an equivalent severance tax on natural gas produced within the State. *Id.* at 731. Three aspects of the first-use tax favored local interests and discriminated against interstate commerce. First, there was an exemption from the tax for OCS gas used for certain purposes within Louisiana but not outside Louisiana. Second, a full credit against the first-use tax was given to producers of gas in Louisiana but not to producers in other States. Third, other tax credits had the effect of shielding Louisiana consumers, but not consumers in other States, from the impact of the tax. On these bases, the Court held that Louisiana's first-use tax was protectionist legislation; it was found to impose as much tax as possible on producers and consumers outside the State and as little tax as possible on producers and consumers within the State. *Id.* at 757, 758.

The only element of the Louisiana first-use tax scheme that bears any resemblance to the Washington wholesaling tax is the credit that was given to producers of OCS gas who also produced gas subject to the Louisiana severance tax. Appellants argue that this credit is similar in effect to Washington's multiple activities exemption, available to local manufacturers if they pay the wholesaling tax. But that exemption differs radically from Loui-

siana's first-use tax credit, which was granted for local economic activity *unrelated* to production of OCS gas. Thus, an OCS gas producer with unrelated production in Louisiana gained a "direct commercial advantage" over an otherwise identical OCS gas producer having no other production in Louisiana. The tax scheme therefore could be said to discriminate against out-of-state companies.

Washington's multiple activities exemption grants no "direct commercial advantage" to a local manufacturer. It does not reward a business for engaging in other economic activity in Washington. All goods are subject to the same rate of tax; both interstate and intrastate businesses are treated neutrally. In fact, the effect of the Washington multiple activities exemption is precisely the opposite of Louisiana's first-use tax credit. The exemption *equalizes* tax burdens placed on goods manufactured in Washington and goods manufactured elsewhere, by ensuring that an item manufactured and sold in Washington will not be subject to a *greater* tax burden than the same item sold in Washington but manufactured elsewhere.

The multiple activities exemption serves two essential purposes. First, the exemption prevents discrimination *against* local business. Without the exemption, local manufacturers that sell their products in the State would pay two gross receipts taxes (one for manufacturing and one for wholesaling), while out-of-state manufacturers selling in the state would pay one gross receipts tax (for wholesaling). In the real world, and contrary to the purely hypothetical situations postulated by appellants, no other State imposes a gross receipts tax on manufacturing. Thus, without the multiple activities exemption, local manufacturers would be disadvantaged in competing with out-of-state manufacturers for sales within the State.

The second essential purpose of the multiple activities exemption, consistently recognized as legitimate for a state tax system, is fairly to "encourage the growth and development of intrastate commerce and industry." *Boston Stock Exchange*, 429 U.S. at 336. In *Boston Stock Exchange*, the Court expressly recognized the validity of "two activities for the price of one" encouragement. While striking down a facially discriminatory amendment to a state tax, the Court approved the State's previous law (*id.* at 330); that law imposed a tax if any one of five taxable events occurred within the State, but if more than one taxable event occurred in the State, only one tax was payable (*id.* at 322). Washington's gross receipts tax does just the same.

For these reasons, the Washington wholesaling tax does not discriminate against interstate commerce. The statute on its face applies to all wholesaling within the State, and the exemption from the manufacturing tax granted to in-state manufacturers merely ensures that no goods will be taxed twice. The tax is a model of a neutral tax that affects all businesses equally. Neither *Maryland v. Louisiana* nor any other decision of this Court supports the invalidation of such a tax under the Commerce Clause.

C. The Application Of The Washington Manufacturing Tax Solely To Local Manufacturers Selling Outside The State Does Not Discriminate Against Out-Of-State Manufacturers Selling Within The State.

In challenging the Washington wholesale gross receipts tax as discriminatory, appellants seem to recognize that this tax applies to all sellers without exception. Yet Xerox and others argue that the application of the manufacturing tax to local manufacturers only when they sell outside the State somehow makes discriminatory the tax imposed on the selling activity of out-of-state manufacturers. Stated another way, they argue that because local manufacturers who sell their products in the State are exempt from the manufacturing tax, the selling tax is discriminatory as applied to out-of-state manufacturers. This argument is without merit for several reasons. Whether viewed by itself or as part of the entire gross receipts tax

scheme, the manufacturing tax is discriminatory neither on its face nor in its effect on out-of-state manufacturers.

First, the manufacturing tax applies identically to in-state and out-of-state manufacturers selling goods in Washington. Neither group pays any manufacturing tax. In-state manufacturers are exempt from the manufacturing tax under the multiple activities exemption, and out-of-state manufacturers are not subject to the tax. In addition, because in-state and out-of-state manufacturers are subject to the same rate of wholesaling tax in Washington, their overall state tax burden is the same.

The record is barren of any evidence that any other State imposes a gross receipts tax on manufacturing. Thus, none of the out-of-state manufacturers selling in the State can be said to pay any higher taxes than a local manufacturer-seller. Because the "actuality of operation" of the Washington tax system does not discriminate against any of the appellants, none of them has standing to challenge the tax.[7]

In any event, Washington's wholesaling gross receipts tax would not be invalid even if another State imposed a manufacturing gross receipts tax, and a manufacturer in that State selling in Washington were thus subject to a greater total tax burden than a Washington manufacturer. Whether Washington provides an exemption for in-state manufacturers should be of no concern to an out-of-state manufacturer because it is not subject to the manufacturing tax either. As applied to out-of-state manufacturers, Washington's system is the same as one that taxes only wholesaling.

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[7] To the extent that *dicta* in *Armco* would excuse a showing of "actual discrimination," it should either be read in the light of the fact confronting the Court in that case, *i.e.*, a statute that was facially discriminatory, or disregarded in favor of the decades of precedent examining the actual operation of challenged state taxes. See discussion *supra*, at pp. 11-14.

In *Armco*, the Court described precisely this type of tax as permissible under the Commerce Clause. The Court stated (467 U.S. at 645):

> It is true, as the State of Washington appearing as *amicus curiae* points out, that Armco would be faced with the same situation that it complains of here if Ohio (or some other state) imposed a tax only upon manufacturing, while West Virginia imposed a tax only upon wholesaling. In that situation, Armco would bear two taxes, while West Virginia sellers would bear only one. But such a result would not arise from impermissible discrimination against interstate commerce, but from fair encouragement of in-state business.

Thus, the claim that the exemption of Washington wholesalers from the *manufacturing* tax makes discriminatory the application of the *wholesaling* tax to out-of-state manufacturers lacks merit, even if they are subject to a manufacturing tax in another state.

D. The Washington Manufacturing Tax Does Not Discriminate Against Local Manufacturers Selling Out Of The State.

A number of appellants represented by Kalama manufacture in Washington products that they sell outside the State. This group claims that Washington's manufacturing tax discriminates against them because they have to pay the tax while local manufacturers who sell their products in-state are exempt.

This argument finds no support in *Armco*, because, in *Armco*, all West Virginia manufacturers paid the same tax regardless of where they sold their products. *Maryland v. Louisiana* also offers no comfort to these appellants because it did not involve a challenge to a manufacturing tax on any products originating in Louisiana. The tax was imposed on a product brought *into* Louisiana from the Outer Continental Shelf, and its effect was to allow a product to be sold in Louisiana at a lower price

than the same product could be sold in other States. *Maryland*, 451 U.S. at 756. The Washington statute works no such discrimination. To the contrary, it is designed merely to equalize the impact of the gross receipts tax on all manufactured goods. Goods manufactured in Washington and shipped elsewhere bear a tax burden of 0.44% when they leave the State; if they are sold to a consumer in the State, they bear the same 0.44% tax when they leave the stream of commerce in Washington. Although the exporter pays the manufacturing tax, and the local seller pays the wholesaling tax, the *dollar* tax burden on each is identical. Thus, the Washington tax system does not enable a consumer in Washington to purchase manufactured goods at a lower price than a consumer of the same goods in another State.

The exemption of local wholesalers from the manufacturing tax is necessary to avoid unfair treatment of local business. If Washington imposed gross receipts taxes on both the local manufacture and the local sale of products, its consumers would have a clear economic incentive to travel to neighboring States to purchase goods. Similar economic consequences, resulting from the imposition of a retail sales tax on goods sold in the State without a compensating use tax on goods brought into the State, have led the States to impose compensating use taxes, long upheld by this Court. *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Washington's multiple activities exemption is the obverse of the same coin; like a compensating use tax, it treats out-of-state and domestic goods equally in order to avoid incentives to residents to make purchases in other States.[8]

The Washington gross receipts taxing system must be viewed in its entirety, just as this Court viewed the

[8] Such "[e]qual treatment of interstate commerce . . . has been the common theme running through the cases in which this Court has sustained 'compensating,' state use taxes." *Boston Stock Exchange*, 429 U.S. at 331.

Washington sales and use tax system in *Henneford*. So viewed, it represents the State's attempt to achieve equality in the treatment of all goods manufactured or sold at wholesale in Washington. The multiple activities exemption is a necessary element of that equality. Without that exemption, local business would suffer an actual discrimination measurable in dollars and cents. With the exemption, interstate commerce suffers neither actual nor meaningful hypothetical discrimination.

Finally, appellants contend that the Washington taxing scheme is flawed because it provides an incentive for businesses to move into the State of Washington to avoid paying both the hypothetical manufacturing tax in the other State and the actual wholesaling tax in Washington. Even if such an incentive existed, however, it would provide no basis for invalidating a state tax under the Commerce Clause. In *Boston Stock Exchange* (429 U.S. at 336-37) and again in *Armco* (467 U.S. at 642), this Court made it clear that so long as a State does not engage in "impermissible discrimination against interstate commerce," it is free to use its taxing system to encourage the growth or relocation of business within the State. Because Washington's taxing system does not so discriminate, any incentive that it may provide for businesses to relocate to Washington is of no constitutional significance.

III. WASHINGTON'S TAX IS APPORTIONED EXACTLY TO THE ACTIVITIES TAXED.

A. The B & O Tax Does Not Result In Multiple Taxation.

Appellants assert that the Washington tax is invalid because it is not fairly apportioned. This argument rests solely on claims of multiple taxation. *See* Brief of *Amici* Amcord, *et al.* ("Amcord"), adopted in National Can Br. 17. But it is clear that, in the context of interstate commerce, the risk of multiple taxation cannot, in and of itself, be the basis for invalidating a state tax. Moreover, Amcord ignores the distinction between a gross receipts tax (such as the B & O) and an income-based tax. As a

consequence, Amcord misstates the tax burden that may constitutionally be imposed on interstate commerce and urges the application of an improper apportionment test.

In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), the Court held that the test for the validity of state taxes imposed on interstate businesses, like appellants, is not whether a tax may result in multiple taxation, but whether the "taxpayer can prove 'by clear and cogent evidence'" that the tax "is in fact 'out of all appropriate proportions to the business transacted . . . in that state.'" *Id.* at 169-70 (quoting *Moorman Manufacturing Co.*, 437 U.S. at 274, and *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931)).[9] Accordingly, appellants' and Amcord's claims of multiple taxation must fail because, quite simply, they have not established by clear and convincing evidence a tax wholly out of proportion to their activities in Washington.

Rather than meet this test, appellants and Amcord offer a simplistic and superficial argument. They contend that because Washington's tax is assessed against 100% of the gross receipts from the sale of goods, it is a tax on their full value, and therefore constitutes multiple taxation if any other State imposes a tax based on the value of the same goods.[10] Thus, National Can contends that it is exposed to multiple taxation because it is subject to a California income tax that uses a base including the

[9] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 451 (1979), which concerned a state tax on foreign commerce, is irrelevant here.

[10] Appellants' argument proves far too much. Their focus on whether the full value of the goods is subject to tax in Washington would seem to render vulnerable even a retail sales tax on any product subject to a gross receipts tax or included in the gross receipts used as the measure of an income tax. The State of destination may constitutionally impose a sales tax (*see, e.g., State Tax Comm'n v. Pacific States Cast Iron Pipe Co.*, 372 U.S. 605 (1963)); and the Court has never suggested that its validity depends on whether it results in the cumulative taxation of more than 100% of the value of the goods.

gross receipts of all sales, including those in Washington. Similarly, Kalama contends that it is subject to multiple taxation because it is subject to an income tax in Illinois based on the proceeds of the sale in that State of goods that it manufactures in Washington.

Washington's gross receipts tax is so different from other States' income taxes that unlawful multiple taxation cannot result. The B & O tax does not use the same measurement of value as an income tax—one taxes the value of doing business in a State, the other the value of the income produced. The two systems are no more comparable than apples and oranges. This Court has often recognized the varying effects and incidents of different kinds of taxes that tax different values, and has upheld the application of state taxes against the claim that they posed a risk of multiple taxation in violation of the Commerce Clause.

In *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 228 n.12 (1980), the Court distinguished a severance tax from an income tax, and upheld the application of the state apportionment formula to net income from oil and gas production even though producing States might impose a severance tax on the gross value of the mineral extracted or the quantity of production. The B & O tax at issue here is very similar to a severance tax, which has in fact been likened to an occupation tax (*ibid.*); both measure the tax against gross value rather than net income. *Ibid.* Thus, the B & O tax can be imposed without regard to any state income taxes to which appellants may be subject.

Similarly, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court distinguished an *ad valorem* property tax from an income tax, noting that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate . . . ." *Id.* at 444. Thus, the Court upheld the application of Vermont's income tax to an apportioned share of dividend income even on the assumption that New York, as the

State of commercial domicile, could impose an unapportioned tax on those dividends. The Court noted simply that Vermont's tax was constitutional because the State sought to tax income, not ownership. *Id.* at 444-46.

These cases make clear that different types of state taxation do not present even the risk of multiple taxation. In some cases, the Court has gone further, upholding state taxes even if they produced actual multiple taxation. In *Moorman Manufacturing Co.*, the Court rejected the claim that "the Commerce Clause prohibits any overlap in the computation of taxable income by the States." 437 U.S. at 278. Thus, Iowa's tax was upheld in spite of the Court's recognition that the State's apportionment of its tax base resulted in multiple taxation. *See also Container Corp., supra* (upholding the tax at issue even though it resulted in actual double taxation).[11]

As noted above, there is no showing in this case of any actual multiple taxation. Thus, the Court need go no further than to recognize, as it has done repeatedly, that the imposition of different types of state taxes creates not even a risk of multiple taxation. Unless the Court is now prepared to prefer as a matter of constitutional law one system over another, it should not invalidate a state tax system merely because it may present the risk of multiple taxation by being "different from the . . . practice of [a] neighbor." *Moorman Manufacturing*, 437 U.S. at 280 n.16.

B. Washington Is Entitled To Apportion By Allocation.

Appellants' and Amcord's apportionment challenge rests on application of the income tax apportionment test. Because of the differences, noted above, between a gross receipts tax and an income tax, the imposition of a formula appropriate to an income tax would invalidate

[11] If multiple taxation resulting from different tax schemes presents a significant obstacle to interstate commerce, the conflict is appropriate for resolution by congressional legislation or through interstate compacts. *See Commonwealth Edison*, 453 U.S. at 628.

any gross receipts tax. Washington's tax should be upheld if it is "apportioned to its activities within the state." *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939) (quoted in *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560, 564 (1975)). As this Court concluded in *Standard Pressed Steel*, the Washington tax meets this test.

A gross receipts tax by definition taxes the value of 100% of the receipts of the taxed activity (*e.g.*, manufacturing or wholesaling) and should not be held invalid merely because it does so. It is invalid only if levied against activities that occur outside of the State. In other words, the gross receipts tax must be "fairly related to the services rendered by [the State], which include police and fire protection, the benefit of a trained work force, and the 'advantages of a civilized society.'" *Exxon Corp.*, 447 U.S. at 228.

The challenged tax here is levied solely at activities occurring within the State of Washington and "is 'apportioned exactly to the activities taxed,' all of which are intrastate." *Standard Pressed Steel*, 419 U.S. at 564. Washington taxes manufacturing within the State and sales at wholesale within the State. Amcord's argument (Br. 9) that goods sold at wholesale in Washington may have received "value" in another State is irrelevant because Washington's wholesaling tax is not a tax on "value added" but a tax on the privilege of engaging in business within the State.[12] This Court has firmly rejected the notion that the Commerce Clause prohibits a tax on the aspects of interstate commerce occurring within a State. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). That is all that the Washington B & O tax reaches.

[12] Because a gross receipts tax is a type of sales tax (J. Hellerstein & W. Hellerstein, *op. cit.* 551), formula apportionment is no more appropriate for a gross receipts tax than for a retail sales tax. *See Standard Pressed Steel*, 419 U.S. at 564.

IV. TYLER PIPE HAS A SUFFICIENT NEXUS TO WASHINGTON TO JUSTIFY APPLICATION OF WASHINGTON'S TAXES TO IT.

Appellant Tyler Pipe raises an argument not pursued by the other appellants—that there is an insufficient "nexus" between Tyler Pipe and the State of Washington to justify the imposition of the gross receipts tax on its sales within the State. (See Br. 10-13). The existence of a "substantial nexus" with the taxing State is part of the Commerce Clause test set out in *Complete Auto Transit*, 430 U.S. at 279. Tyler Pipe also contends that there is not a "minimal connection" between its activities and the State of Washington sufficient to support the Washington tax against the limitations imposed by the Due Process Clause. As Tyler Pipe recognizes (Br. 11), the two tests are similar. *See, e.g., Exxon Corp.*, 447 U.S. at 228 (equating the due process nexus requirement with the Commerce Clause test). Both arguments rest primarily on the fact that Tyler Pipe maintains no office in Washington and fills orders directly from its Texas headquarters.

Tyler Pipe's sales in Washington are solicited by independent sales representatives rather than through its own employees. These representatives "handle all sales functions pertaining to [Tyler Pipe's] products in [the] state" and receive a commission on all sales made in their territory even if the customer contacts Tyler Pipe directly. J.S. App. in 85-1963, B-9. The representatives "maintain and improve [its] name recognition, market share, goodwill, and individual customer relations" and transmit to Tyler Pipe "[v]irtually all [the] information" concerning the Washington market that is "necessary to keeping [it] competitive in the marketplace." *Id.* at B-9 to B-10.

There is no question that, if the activities of Tyler Pipe's sales representatives were performed instead by employees, the "substantial nexus" and "minimal connection" tests under the Commerce Clause and the Due Process Clause, respectively, would be easily satisfied. That much is settled by this Court's decision in *Standard*

Pressed Steel, which upheld the imposition of the very tax at issue here upon an out-of-state manufacturer because of the presence in the State of a single employee who serviced a single customer. That employee performed services quite similar to, although not even as extensive as, those performed for Tyler Pipe by its independent sales representatives. In *Standard Pressed Steel*, the employee operated out of his home, consulting with the customer concerning its needs, and following up on sales after delivery of the product. Orders were sent directly to, and filled by, Standard Pressed Steel from its out-of-state home office, to which all payments were also sent.

This Court found a sufficient "nexus" for Commerce Clause purposes between the employee's local activities in Washington and Standard Pressed Steel's interstate sales. The opinion distinguished *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951), on which Tyler Pipe places heavy reliance, because in that case, the State had not established a sufficient factual nexus between Norton's Chicago office and some of the sales made directly from its Worcester, Massachusetts, headquarters. The Court found that Standard Pressed Steel's situation more closely resembled that in *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), where the activities of non-selling district managers and service representatives were held sufficiently substantial "with relation to the establishment and maintenance of sales, upon which the tax was measured." *Id.* at 447, quoted in 419 U.S. at 563.

The Court decisively rejected Standard Pressed Steel's due process challenge to the tax as "verg[ing] on the frivolous." 419 U.S. at 562. The Court explained that the employee "made possible the realization and continuance of valuable contractual relations between the taxpayer and its customer." *Ibid.* In effect, the Court applied a "but for" test, upholding the tax because the Company would not have been able to make the sales on which it was being taxed but for the activities of the employee.

Similarly, in the present case, the local activities of the independent sales representatives provide a sufficient nexus to satisfy the Commerce Clause and sufficient minimal contacts to satisfy the Due Process Clause. Those sales representatives engage in substantial activity "with relation to the establishment and maintenance of sales, upon which the tax [is] measured" (*General Motors Corp.*, 377 U.S. at 447) and "[make] possible the realization and continuance of valuable contractual relations" (*Standard Pressed Steel*, 419 U.S. at 562) between Tyler Pipe and its customers in the State of Washington.

Tyler Pipe nevertheless argues that it cannot be taxed because it is represented in Washington by independent sales representatives who are not its employees. The very same formalistic argument was unsuccessfully urged in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), where the Court held that the Due Process Clause does not differentiate between independent sales representatives and direct employees with regard to state tax liability. In *Scripto*, the Court upheld a Florida statute requiring a Georgia company, with no full-time employees in Florida, to collect and pay use taxes for goods sold in Florida through independent sales representatives. The Court explained (*id.* at 211-12):

> True, the "salesmen" are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida . . . . Moreover, we cannot see, from a constitutional standpoint "that it was important that the agent worked for several principals." . . . The test is simply the nature and extent of the activities of the appellant in Florida.

As the *Scripto* decision exemplifies, this Court has examined constitutional challenges to state taxes in terms

of real situations rather than legal forms. Tyler Pipe, for reasons of its own convenience, has opted to handle its Washington sales by contractual relations with independent agents rather than through its own employees. Its Washington sales should not be exempt from state tax simply because of the form of business association through which it chooses to conduct its business.

The Court has firmly rejected any such formalistic dependence on physical presence in the State in another context, the due process requirements for a state court's exercise of jurisdiction over a nonresident defendant. There is no question that Washington state courts may assert jurisdiction over Tyler Pipe on the basis of its substantial activities there. The exercise of judicial jurisdiction satisfies due process concerns when the defendant's contacts with the forum state "proximately result from actions by the defendant *himself* that create a 'substantial connection' with [that] state." *Burger King Corp. v. Rudzewicz*, 105 S. Ct. 2174, 2184 (1985), *citing McGee v. International Life Ins. Co.*, 355 U.S. 220, 223 (1957). A defendant that "purposefully avails itself of the privilege of conducting activities within the forum state" (*Hanson v. Denckla*, 357 U.S. 235, 253 (1958)), may not avoid the jurisdiction of its courts "merely because the defendant did not *physically* enter the forum state." *Burger King*, 105 S.Ct. at 2184. Such a rule is fair because of the "inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted." *Ibid.* For the same reasons, Tyler Pipe should be required to bear its fair share of Washington's taxes. "The activities which establish [the company's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." *International Shoe Co. v. Washington*, 326 U.S. 310, 321 (1945); *see also Shaffer v. Carter*, 252 U.S. 37, 49 (1920).

To permit the label that a business may place on its relationships with the agents who create its profits to obscure the benefits that these agents and the business itself receive from the State would place a premium on the creativity of the business community to devise corporate arrangements that will insulate it from paying its fair share of state taxes. This Court's encouragement of such creativity would serve no legitimate purpose, but would severely jeopardize the States' ability to raise sufficient revenue in a fair and equitable manner. Tyler Pipe's challenges to the Washington tax should therefore be rejected.

CONCLUSION

The judgments of the Washington Supreme Court should be affirmed.

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